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DEPT PASS TO USTR DHARTWICK/CLILIENFELD/AADLER
DEPT PASS TO TREASURY FOR OFFICE OF SOUTH ASIA ABAUKOL
TREASURY PASS TO FRB SAN FRANCISCO/TERESA CURRAN
STATE FOR SCA/INS AND EB/TRA JEFFREY HORWITZ AND TOM ENGLE

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SUBJECT: NEW DELHI WEEKLY ECON OFFICE HIGHLIGHTS FOR SEPTEMBER
24-28, 2007

NEW DELHI 00004419 001.2 OF 004

¶1. (U) Below is a compilation of Economic highlights from Embassy New Delhi for the week of September 24-28, 2007.

MIXED SIGNALS ON RETAIL

¶2. (U) Two key GOI figures in the U.S. this week gave conflicting messages on the future of organized retail in India. Minister of Commerce and Industry Kamal Nath, speaking at an "India AT 60" event in New York on Monday, said that the governing issue in retail policy is not FDI versus indigenous companies, but large versus small, referring to many small retailers' fears that their livelihoods are threatened by organized players. He explained that the GOI is interested only in incremental growth in the sector but did not clarify what that might mean, leaving the press to infer that Nath was pessimistic about greater FDI in retail. Then on Thursday, Finance Minister Chidambaram, addressing an audience at the Wharton Business School, said that it was only a matter of time before India permitted greater FDI in retail, adding that the GOI would gradually convince small retailers that they can coexist with organized retailers, clearing the way for greater liberalization. Currently, the GOI permits 51 percent FDI in single-brand retail and 100 percent FDI in wholesale and cash-and-carry formats but does not allow FDI in multi-brand retail.

¶3. (U) Reliance Fresh had another busy week on the ground. Monday saw violent trader protests interrupt the opening of a pair of outlets in the state of Orissa. The press also reported that Reliance Fresh will pull out of Uttar Pradesh (UP), India's most populous state, because the government there has proved intractable. UP Chief Minister Mayawati has not rescinded her closure order on Reliance outlets in the state, nor has the committee she assigned to study the affects of organized retail produced its report, though the one-month deadline Mayawati set at the time of the closures has passed. (Note: Although Mayawati declared on August 23 that all free-standing produce retailers in the state had to cease operation,

only Reliance Fresh actually closed most of its doors. The press tends to ignore the fact that Spencer's and others have remained open. End note.) Reliance reportedly has begun lay-offs of 1,000 of its 2,800 total employees in the state and will relocate many others.

¶4. (U) Despite these setbacks, Reliance Retail marches ahead. The company quietly opened nine Reliance Fresh outlets in Mumbai midweek and pushed ahead with its effort to become a franchisee for Gap clothing brands. Gap, which has demonstrated some reluctance to work on the franchise model, has had discussions with many Indian companies, but The Economic Times reports that Reliance is the frontrunner to close the deal.

COOPERATION ON
URBAN TRANSPORT

¶5. (U) On September 24, the Department of Transportation signed a Memorandum of Cooperation (MOC) with Minister Jaipal Reddy of the Ministry of Urban Development. The MOC signing was overseen in New Delhi by Deputy Administrator Sherry Little of the Federal Transit Administration (FTA), under the Department of Transportation. The FTA visit is a follow on to a trip by Minister Reddy and colleagues to view urban infrastructure and mass transit systems in the US earlier this year in May. Under the MOC, both governments will look for opportunities to collaborate on public transport, inter-modal transportation, safety in transport, transport for persons with disabilities, Intelligent Transportation Systems, Traffic Information Centre, capacity building and training in public transportation, and other fields of mutual interest.

¶5. (U) This is an important development at a time when the central government is focusing on India's infrastructure gaps and ways to attract much needed investment as well as the Ministry of Urban Development's focus on emphasizing urban transport policy as a key element in building urban infrastructure. Following the signing,

Urban Development(Minister Jaipal Reddy said: "Large-scale urbanization in India has put severe strain on urban infrastructure which includes water supply, road and transport, sewerage and sanitation, drainage, and solid waste management. If momentum of economic growth is to be maintained, challenges thrown up by large-scale urbanization will have to be addressed without delay."

DEDICATED FREIGHT CORRIDORS
OF THE INDIAN RAILWAYS -
A MATTER OF DEBATE

¶6. (SBU) The Japan Bank for International Cooperation (JBIC) has proposed to offer loans at attractive rates to build Dedicated Freight Corridors (DFC) in India subject to two preconditions: (1) both east (Delhi-Kolkata) and west (Delhi-Mumbai) corridors are electrified and (2) electric locomotive manufacturing in India is established under public private partnerships (PPPs) with Japanese manufacturers. While India certainly welcomes Japanese assistance in developing railway corridors (as GOI has done with other infrastructure development projects - most notably the Delhi metro), USG is advocating that the above two preconditions are simply not sound economics.

¶7. (U) The Indian Railways has asked the GOI to not electrify the Western DFC since it is likely to handle a lot of container traffic from Indian ports and northern Indian cities to Delhi which necessitates double stack and triple stack container operations. Such operations require significantly higher investment (approximately five more times) when run on electrified lines versus non-electrified lines.

INDIAN RAILWAYS SEEK PPPS
FOR MANUFACTURING DIESEL
LOCOMOTIVES

¶8. (SBU) GE Rail estimates that Indian Railways faces an annual deficit of 500 to 700 diesel locomotives - above and beyond the country's current diesel locomotive manufacturing capacity. GE also notes that the Indian Railways, through its production arm of Diesel Loco Works (DLW), has the capacity to manufacture about 150 to 200 diesel locomotives per year or 1,000 trains in the next five years. Given the apparent shortfall and expected future demand, Indian Railways is seeking to enter into a PPP joint venture for the establishment of a new greenfield locomotive manufacturing facility in India (rumored to be in Bihar, Railways Minister Lalu Prasad's home state). GE anticipates taking a 74 percent stake in this joint venture and thereby, maintaining operational control. This order is valued at approximately USD 4 billion.

¶9. (SBU) In order to meet Indian Railways' short-term locomotive needs, GE envisions several phases, whereby a first phase launch order of 50 fully assembled locomotives would be shipped from its manufacturing hub in Erie, PA. The second phase would entail 450 locomotive kits to be sourced from Erie and assembled in-country. After which, any remaining orders would be processed at the new locomotive manufacturing facility in India. Even after this plant is fully operational, GE still anticipates that certain core equipment, like the rail traction and braking systems, would still be sourced from Erie along with other maintenance and service work. GE estimates this commercial opportunity at USD 1.3 billion with approximately USD 520 million in U.S. content (goods and parts imported from the United States).

¶10. (SBU) GE foresees competition from Transmash (Russia), Dalian (China), QSY (China), and EMD (LaGrange, Illinois). GE also expects Indian Railways to release a similar tender for the establishment of a new electric locomotive facility. As such, GE anticipates that the Europeans and the Japanese will be lobbying Indian Railways to increase the number of electric locomotives.

MOVING FROM SERVICES
TO MANUFACTURING LED
GROWTH

¶11. (U) On September 27, during a major economic summit, Secretary Ajay Shankar from the Department of Industrial Promotion and Policy (DIPP) at the Ministry of Commerce and Industry commented on the bright performance of the manufacturing sector during the last two to three years. He was confident that India will emerge as the world's favorite manufacturing base within a decade when infrastructure constraints will cease to exist given other comparative advantages - such as low cost labor, good product quality, stable political and legal environment, strong knowledge base, and a big consumer market.

¶12. (U) While giving the keynote address at the summit, Secretary Shankar pointed to the flashy double digit growth rate of the Indian manufacturing sector since 2005-06, despite facing infrastructure bottlenecks and regulatory obstacles. He was emphatic that the 1990s' perception of India having a competitive advantage in only services and not manufacturing is changing with many MNCs opting for India as one of their production bases with future expansion plans. Shankar also discussed how the GOI is prioritizing infrastructure development and hopes to attract huge investments for the sector through public private partnerships, special economic zones (SEZs), and themed manufacturing clusters which attract FDI. Other efforts include rationalization of regulatory procedures at the micro level to save cost and time, skill enhancing training programs, education management based on industry needs, and promotion of an intellectual property culture.

¶13. (U) Also featured on the panel were private sector representatives from Motorola, Microsoft India, Infotech Enterprises, Sri City SEZ, AT Kearney India, Yes Bank, and Quatrro BPO Solutions. They all agreed with Secretary Shankar's assessment that India has the ability to emerge as a major global manufacturing hub in the middle to long-term as evidenced by the remarkable transformation of the sector. Panelists commented that India is no

longer just an IT service provider, but that its strength leans towards vibrant knowledge based manufacturing units (in engineering, design, and R&D). While the company representatives expect the strong performance in manufacturing to continue for sometime, they were also quick to point out that problems relating to infrastructure and taxation need to be addressed for overall economic growth and sector expansion.

¶14. (U) According to the panel, India's manufacturing sector is playing a pivotal role in the economy with a 21 percent share of GDP, 7 percent of total FDI inflows, and 51 percent of total exports. India is rapidly emerging as a sourcing base for global operations. Key manufacturing sectors propelling growth over the last two years are engineering, automobiles, chemicals, textiles, electronics, and hardware. The next wave of growth is expected in food processing, pharmaceutical and biotech, and wind energy.

¶15. (U) The telecom industry representative stated that the telecom revolution in recent years has led to 7-8 million additional mobile phones each month in India. Multinational companies like Motorola and Nokia are finding it profitable and easier to manufacture mobile equipment in India rather than exporting big consignments. Now that R&D is driven mainly by the private sector, India has great potential to become a world leader in R&D activities. India also scores better than China in this field as the Indian R&D industry is both traditional and knowledge based.

¶16. (U) With the development of SEZs across the country, panelists predicted that manufacturing activities are slated to pick up drastically. They also concluded that the SEZ concept may also prove beneficial for India's infrastructure integration efforts, thereby making India an attractive destination for manufacturing giants.

¶17. (U) Visit New Delhi's Classified Website:
http://www.state.sgov/p/sa/newdelhi

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